OPENING STATEMENT OF
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HEARING ON THE PROMOTION OF
CAPITAL AVAILABILITY TO AMERICAN BUSINESS

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Mr. Chairman, thank you for the opportunity to speak before we begin today's hearing on the promotion of capital availability to American business. As the Ranking Democratic Member on the Capital Markets Subcommittee, I want to maintain the competitiveness of our nation's capital markets. These resources help American businesses to compete in the international marketplace. They also help our nation to remain productive, providing better jobs at higher wages for American workers and improving the quality of life for American families.

It is therefore appropriate and constructive for us to hold a hearing at this time on the two revised merchant banking rules issued by our nation's financial regulators earlier this year. These proceedings will help us to determine whether these regulations run counter to the purposes of the Gramm-Leach-Bliley Act or whether they capture the essence of the law's intent.

During the debates over the modernization law, one of the most contested issues was the extent to which we should break down the legal barriers that separate banking and commerce. In Japan, the intermingling of these sectors via cozy *kieretsu* combinations probably contributed to the great inefficiencies that first produced the economic disorder in their banking system in the 1990s which continues today. Ultimately, Congress learned from these experiences and we enacted a law that maintains firewalls between banking and commerce.

A closely related issue that we examined in the overhaul of the financial services industry concerned merchant banking, which refers to commercial banks' equity investments in non-financial firms. In our deliberations, we recognized the importance of merchant banking in providing equity capital to the private sector, but decided that for at least five years only units of financial holding companies could engage in such activities. The law consequently permits these units to acquire equity investments in non-financial companies and to sponsor equity funds provided that they limit their ownership positions and that they lack day-to-day management control in these investments.

In March 2000, the Federal Reserve and the Treasury Department issued interim and proposed regulations to implement the merchant banking provisions of the modernization act. These proposals generated considerable debate among affected parties and in the press. Of particular concern to me -- as well as to many of my Democratic colleagues -- was the effect of the proposals on Small Business Investment Companies or SBICs, which bring important capital resources to small businesses and the communities in which they operate.

Because commercial banks represent the largest source of the SBIC program's private funding, concerns arose that provisions contained in the merchant banking rulemaking, such as the proposed 50 percent capital charge on all equity investments, would have constricted the availability of financial resources for small businesses. During our Subcommittee's prior hearing on the interim rules, I expressed considerable concerns about the consequences of the proposal on SBICs, and I urged the regulators to create a limited carve-out under their merchant banking rules for such investments. To their credit, the regulators responded to many of my concerns when issuing a revised capital proposal for non-financial equity investments in January 2001.

As I noted earlier, in passing the Gramm-Leach-Bliley Act, we maintained the firewalls preventing the indiscriminate mixing of banking and commerce. From my perspective, it remains very important for our federal financial regulators to strike an appropriate balance between allowing financial holding companies to engage in merchant banking activities and insulating commercial banks, which carry federal deposit insurance, from the associated risks.

In closing, Mr. Chairman, my colleague in the other body, Senator Paul Sarbanes of Maryland, perhaps said it best when he noted that the financial modernization law gave the Federal Reserve and the Treasury the ability to jointly develop implementing regulations on merchant banking activities to "define relevant terms and impose such limitations as they deem appropriate to ensure that this new authority does not foster conflicts of interest or undermine the safety and soundness of depository institutions or the Act's general prohibitions on the mixing of banking and commerce." Although I generally agree with his assessments, I believe it equally important that we at least learn more about the views of the parties testifying before us today and, if necessary, work to further refine and improve the merchant banking regulations in the future.